Chapter 9

Superiority of Basel II over Basel I

ABSTRACT

This chapter explores the presumed superiority of Basel II over Basel I, and assess the effectiveness of Basel II in empirical risk management and prudential supervision practices, as reflected in a series of 15 interviews undertaken with bank risk managers, senior analysts, and supervisors from regulatory authorities in Australia shortly before and after the 2008 global banking crisis. This chapter and the next represent an important contribution, as these experts and professional are charged with the implementation of the Basel framework, and so are well qualified to identify both its strengths and its weaknesses. In addition to providing an insider’s insight into the operation of the Basel II system, the interviews also permit an investigation of the degree of congruency in the approach and views of bank practitioners in one hand, and regulators on the other. The tendencies discovered may be at play also distorting communicative practices in risk management and supervision under the Basel III framework.

INTRODUCTION

Thus far this research has assessed the efficacy of Basel II & Basel III in terms of its claims to be an example of ‘smart’ regulation in regard to its technical attributes. Now we come to the significant and distinctive contribution of this book – namely the qualitative research which allows us to hear the ‘voices’ of practitioners from the banking industry and from supervisory regulators. This chapter is the first of two

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chapters that explore the presumed superiority of Basel II over Basel I, and assess the effectiveness of Basel II in empirical risk management and prudential supervision practices, as reflected in a series of 15 interviews undertaken with bank risk managers, senior analysts, and supervisors from regulatory authorities in Australia shortly before and after the 2008 global banking crisis. This chapter and the next represent an important contribution, as these experts and professional are charged with the implementation of the Basel framework, and so are well qualified to identify both its strengths and its weaknesses. In addition to providing an insider’s insight into the operation of the system, the interviews also permit an investigation of the degree of congruency in the approach and views of bank practitioners on one hand, and regulators on the other. In terms of Habermasian methodology, this will permit an understanding of whatever tendencies may be at play distorting communicative practices in risk management and supervision.

This chapter focuses on the issue of the superiority of Basel II relative to Basel I. In the first few sections, interviewees offer their appraisals of Basel II in terms of its purported broader risk categorization, strengthened underlying risk methodology, and better performance in stressed market conditions. Later sections then seek to evaluate the operational effectiveness of Basel II itself, when interviewees comment on the effectiveness of underlying risk methodologies; the practicability of Basel II; the organizational impact on banks and supervisions; and, the risk culture built into Basel II implementation. The last section summarizes the findings.

INADEQUACIES OF BASEL I IN IMPLEMENTATION

The design of Basel II:

Seek(s) to “improve” on the existing rules by aligning regulatory capital requirements “more closely” to the underlying risks that banks face. In addition, the Basel II framework is intended to promote “a more forward-looking” approach to capital supervision; one that encourages banks to identify the risks they may face, today and in the future, and to develop or improve their ability to manage those risks. As a result, it is intended to be more “flexible and better able to evolve with advances in markets and risk management practices” (BIS, n.d.).

The above brief description of Basel II, from the BIS website, reveals the core intentions of Basel II’s design. In particular, the italicized words highlight the crucial importance of sensitivity, which can be argued to be reflected by: a broader categorization of risk; an underlying stronger methodological design; an improved ability to respond to the economic environment; and a correction of the weakness of the
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The “Smart” Regulatory Features of Basel II and Basel III
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